BEFORE THE ARIZONA CORPORATION COMMISSION

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IN THE MATTER OF THE APPLICATION OF ARIZONA-AMERICAN WATER COMPANY, AN ARIZONA CORPORATION, FOR A DETERMINATION OF THE CURRENT FAIR VALUE OF ITS UTILITY PLANT AND PROPERTY AND FOR INCREASES IN ITS RATES AND CHARGES BASED THEREON FOR UTILITY SERVICE BY ITS AGUA FRIA WATER DISTRICT, ANTHEM WATER DISTRICT, HAVASU WATER DISTRICT, MOHAVE WATER DISTRICT, PARADISE VALLEY WATER DISTRICT, SUN CITY WEST WATER DISTRICT AND TUBAC WATER DISTRICT.	Docket No. W-01303A-08-0227
IN THE MATTER OF THE APPLICATION OF ARIZONA-AMERICAN WATER COMPANY, AN ARIZONA CORPORATION, FOR A DETERMINATION OF THE CURRENT FAIR VALUE OF ITS UTILITY PLANT AND PROPERTY AND FOR INCREASES IN ITS RATES AND CHARGES BASED THEREON FOR UTILITY SERVICE BY ITS AGUA FRIA WASTEWATER DISTRICT, ANTHEM WASTEWATER DISTRICT AND MOHAVE WASTEWATER DISTRICT.	Docket No. SW-01303A-08-0227

RUCO'S REPLY BRIEF

RATE BASE ADJUSTMENTS

RATE BASE ADJUSTMENT – WHITE TANK CWIP

The Company admits that placing CWIP in ratebase departs from "traditional ratemaking." Company Brief at 20. In fact, allowing CWIP in ratebase is extraordinary ratemaking. Nonetheless, the Company believes that its recommendation to include CWIP in ratebase is fair to customers for three reasons. First, the Company argues that allowing the Company's financial condition to deteriorate is not in its customers' best interests. Id. at 20. Second, current customers will benefit from the White Tank Plant and third it will mitigate rate shock and allow rate consolidation in the future. Id. The Company's reasons are not compelling and the Commission should reject the Company's request.

The fact that customers will benefit is hardly an unusual consequence of building plant. It is not unusual that a Company's financial situation will suffer during the course of building plant. The costs involved in building the White Tank Plant are significant. The costs are also normal expenditures necessary to provide service and place the shareholders at no greater risk than the costs associated with any other plant. The Company's shareholders' will have an opportunity to earn a return on their investment when the plant is placed in ratebase.

The costs involved are not prohibitive. The Company has not claimed that building the plant threatens its solvency. Nor has the Company claimed that its recommendation, if rejected will result in it "mothballing" the project. Transcript at 412. The Company's president, Paul Townsley testified that there has been no decision made at this time to mothball the project. Id. The Company will evaluate its options including selling the plant. Id at 413. Mr. Townsley claims that he is a "proponent" of the plant because it allows the Company to use renewable water in an area that has dwindling groundwater supplies. Id. at 415.

The Company's argument that $25 million in CWIP will help mitigate its financial deterioration caused by what amounts to the decline in home construction is even less compelling. Id at 17-18. Again, allowing CWIP in ratebase is extraordinary ratemaking – the Company's claim that the plant costs have contributed to its deteriorating financial situation even if true is not extraordinary. Moreover, it was the Company that proposed the hook up fees to pay for the plant costs based on faulty growth projections two years ago. Now that the economy has deteriorated, the Company wants to completely abandon its original proposal that was approved by the Commission based on new estimated growth projections which go out through 2013. Id. Only two years have passed since the Commission decided the issue and the Company has not presented any evidence that shows its projections for the next 4-5 years are going to be any more accurate than its projections for the last two years. It is possible that the economy will pick up in that time and new construction will exceed the Company's dim projections. The Company's proposal to recover its costs through CWIP will unfairly shift the risk associated with growth from its shareholders to its ratepayers. The Commission should reject the Company's proposal.

The Company's second reason in support of its recommendation is also not persuasive. Ratepayers' should always benefit from plant or improvements. The purpose for any utility investment is ultimately to provide service. The ratepayers should only pay for plant that provides service from which ratepayers benefit. The ratepayer benefit applies to all plant and not just the plant in question.

Finally, the Company's argument that its proposal will mitigate rate shock and enable rate consolidation should be discounted. The Company claims that it will be forced to file another rate case if its proposal is rejected. Id. at 19. The threat of a rate case should not scare the Commission. The Commission is charged with deciding rate cases and the Company should file a rate application when it feels it is necessary. In this case, it is not only in the ratepayer's interest but the public interest for the Commission to determine the White

Tank Plant issue after the plant is in service and used and useful. The Commission should not make that determination now since the plant is not built. In terms of fairness, common sense and sound regulatory practice, the best solution is for the Commission to decide the ratemaking treatment after the plant is in service and used and useful.

The Company claims that its proposal would enable rate consolidation in the future. Id. The Company offers no explanation why consolidation would be impeded by the Commission's rejection of its proposal. RUCO does not see how the failure of the Commission to adopt the Company's proposal will impede consolidation should the Commission decide to go that route in the future.

RATE BASE ADJUSTMENT – ACCUMULATED DEPRECIATION

RUCO incorporates its position set forth in its Closing Brief. Closing Brief at 4-5.

RATE BASE ADJUSTMENT - ADVANCES IN AID OF CONSTRUCTION ("AIAC") AND CONTRIBUTIONS IN AID OF CONSTRUCTION ("CIAC") ASSOCIATED WITH CWIP.

The Company maintains that the AIAC and CIAC associated with CWIP should be excluded from ratebase since CWIP is being excluded from ratebase. Company Brief at 33-34. The Company appears to draw a distinction between advances and contributions that are funds and those that are plant. Id. at 33. The Company argues that since the advances/contributions are plant there are no funds available to build other plant. Id. Whether the advances/contributions are cash or plant makes no difference for ratemaking purposes. The AIAC/CIAC associated with CWIP should be included in ratebase.

Staff correctly points out that the definition of CIAC does not distinguish between CIAC associated with CWIP and CIAC associated with plant in service. Staff Brief at 11. Moreover, it is the Company that chooses the form of the advances and contributions it accepts. If the Company accepts plant, then it is not expending funds for the plant and thus has funds for other uses. Regardless of how the Company accepts AIAC/CIAC, the ratemaking treatment should not change. The Commission should reject the Company's request to exclude AIAC/CIAC from ratebase associated with CWIP.

RATE BASE ADJUSTMENT – VARIOUS ADJUSTMENTS PERTAINING TO DIFFERENT DISTRICTS

RUCO incorporates its position set forth in its Closing Brief. Closing Brief at 6-7.

RATE BASE ADJUSTMENT – WISHING WELL WASTEWATER TREATMENT FACILITIY

RUCO recommends that fifty percent of the Wishing Well Wastewater Treatment Facility be excluded from ratebase until such time as the Commission determines that it is used and useful. RUCO's recommendation is based on a response to a data request from Staff's engineer, Dorothy Haines. RUCO Brief at 7-8, R-9 at 16. Ms. Hains concluded that "based on the projected next five-year growth rate and 2007 wastewater flow data, this project is more than 50% overbuilt." Id. While the Company appears to acknowledge the data response, the Company appears to discount it because Ms. Hains did not "specify any excess capacity" in her subsequent direct and surrebuttal testimony. Company Brief at 30.

The Company goes on to explain that Ms. Hains had no opinion as to what portion of the new construction costs was excess capacity. Company Brief at 30. In support, the Company references the Q & A:

> Q. (Mr. Pozefsky): And what percentage of the plant, in your opinion, is excess capacity?
>
> A. (Ms. Hains): This will be difficult to give you answer, because company saying they designing the expansion is based on the ADEQ Engineering Bulletin 11. In there, guidelines saying any plant owner, when they designing, they should be based on projected 10 to 15 years growth in there. And then so to making cost effective, they should follow that rule. So I'm not quite understanding what you aim to. Id., Transcript at 756.

Apparently, the Company overlooked the Q & A that followed:

Q. Maybe let me ask it another way. What percentage of the plant is currently not being used?

A. Plant right now have a capacity of .5 million gallons. And then test year, they showed the peak day flow was .27 MGD, and that's a year ago data. I do not know '08 until now what the flow looks like. So based on .27 versus the .5, that's more close to almost 48 percent. Transcript at 756.

Ms. Hains' hearing testimony was consistent with her previous response to RUCO's data request. The Commission should approve RUCO's recommendation to exclude 50% or ($2,138,020) of the costs associated with the Wishing Well Treatment Plant expansion.

The Company next argues that its decision to expand was prudent. Company Brief at 32. The Company also argues that the expansion could not reasonably been any smaller. Id. RUCO does not take issue with either of these arguments. The prudency of the Company's decision is not the same as whether the plant is used and useful. The plant was overbuilt and current ratepayers should not have to pay for plant that is not either used and/or useful. RUCO is not suggesting, as the Company infers, that the Company never recover the excess capacity. RUCO agrees that the plant expansion costs should be recovered when the Commission determines that the plant is used and useful.

RATE BASE ADJUSTMENT - CASH WORKING CAPITAL

RUCO incorporates its position set forth in its Closing Brief. Closing Brief at 8-10.

OPERATING ADJUSTMENTS

RUCO OPERATING ADJUSTMENT – RATE CASE EXPENSE

RUCO incorporates its position set forth in its Closing Brief. Closing Brief at 10-11.

RUCO OPERATING ADJUSTMENT – WHITE TANKS DEFERRAL MECHANISM AND HOOK-UP FEE ACCOUNTING CHANGES

RUCO recommends the Commission reject the Company's request to defer the O&M costs associated with the White Tanks Plant. RUCO also recommends the Commission not approve the Company's request to change the accounting for the treatment of the hook-up fees associated with the White Tank Plant once the plant goes into service.

RUCO acknowledges that the costs of the White Tanks Plant are significant. RUCO also agrees that the plant will benefit ratepayers as well as the environment once completed. For these reasons, as well as other lesser reasons, RUCO would not oppose the deferral of O&M expenses collected from the time the plant goes into service until the Company's next rate case provided the Company continues to operate the plant on its own. RUCO would also agree to extend the collection period for the hook-up fees through 2020. RUCO believes that the Company should adhere to the rest of the Commission previous decision on this matter – Decision No. 69914.

RUCO OPERATING ADJUSTMENT - ACHIEVEMENT INCENTIVE PAY ("AIP")

The Company does not oppose RUCO's proposed AIP adjustment. A-29 at 10.

RUCO OPERATING ADJUSTMENT - FUEL AND POWER SUPPLY ADJUSTMENT MECHANISM

RUCO incorporates its position set forth in its Closing Brief. Closing Brief at 13-15.

RATE DESIGN

THE TOWN OF PARADISE VALLEY PUBLIC SAFETY SURCHARGE

RUCO and the Company are in agreement on this issue. RUCO recommends that the Commission adopt the Company's request to eliminate the High Block Usage Surcharge at the conclusion of this case and to leave the Public Safety Surcharge set at zero.

PARADISE VALLEY SYSTEMS BENEFIT SURCHARGE

RUCO incorporates its position set forth in its Closing Brief. Closing Brief at 15.

GROSS REVENUE CONVERSION FACTOR ("GRCF")

RUCO inadvertently did not address this issue in its Opening Brief. The Company is correct that this issue remains in dispute. Company Brief at 43. RUCO recommends that the Commission not include property tax in its calculation of the GRCF. RUCO has historically excluded property tax from its GRCF. In the Company's recent Sun City and Sun City West Wastewater case (Docket No. WS-01303A-06-0491), Staff inexplicably changed its normal approach which, like RUCO's approach, excluded property tax from the GRCF calculation. The Commission adopted Staff's new approach and determined that it was reasonable. Decision No. 70209 at 19. RUCO believes that its approach is reasonable and should be adopted by the Commission.

RATE CONSOLIDATION

RUCO agrees that the Commission should consider the issue of rate consolidation when all of the districts are the subject of a rate case. RUCO supports the Company's proposal to consider rate consolidation in one docket. Closing Brief at 51. RUCO would not support reopening this docket or the next rate case docket to apply a new rate design to the design the Commission approves in a prior rate case. RUCO believes the cleanest way this can be done is in the context of one rate case with all the districts. The Commission could simply consider a consolidation proposal in the next rate case or the Commission could create a sub-docket in the next rate case. These alternatives are legal, simple and much cleaner approaches to considering rate consolidation for all the districts. Consolidation of rates in this docket would result in the inequitable spread of costs over some, but not all, of the districts. Furthermore, rate consolidation for disparate, discrete and non-contiguous districts would constitute a change in the way the Commission has designed rates up to now. The record in this docket detailing policy reasons for this dramatic shift is sparse. While there may be noble and just reasons for rate consolidation, they should be thoroughly vetted on the record and then applied evenly to all districts.

COST OF CAPITAL

RUCO continues to urge the Commission to adopt RUCO's recommended 8.88 percent return on common equity and overall 7.00 rate of return. The Company criticizes RUCO for failing to apply a risk premium to its cost of equity recommendation as RUCO has typically done in the past. Company Brief at 47. The Company's concern is that RUCO has failed to recognize the Company's increased financial risk due to the Company's highly leveraged capital structure. Company Brief at 47. The Company argues that RUCO's recommendation fails to reflect the current market conditions. Id. at 46.

The Company is mistaken. It is precisely the current market conditions that serve as the basis for RUCO's recommendations. Water utilities, like most utilities, are safe and stable investments. R-2 at 9. The country is in a recession with stock prices falling dramatically. A stable water utility is a very attractive alternative to the record breaking declines non-regulated stocks have seen over the last year and a half. RUCO's recommendation to forego a risk premium in this case is the result of, and not the failure of, recognizing the current economy,

Moreover, the Company has not shown much progress in improving its equity levels in its capital structure. The Company should not have an expectation that the Commission will approve a hypothetical capital structure, risk premium, or other method designed to increase the Company's cost of equity in each case. The Company needs to make efforts to improve its capital structure and not depend on the Commission to always come to the rescue. The Commission should approve RUCO's recommended cost of capital.

CONCLUSION

For all the reasons set forth, the Commission should approve RUCO's recommendations.

RESPECTFULLY SUBMITTED this 15th day of May, 2009.

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